

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Ndlambe Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Ndlambe Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Ndlambe Local Municipality as at 30 June 2019, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (DORA).

Basis for qualified opinion

Property, plant and equipment

3. The municipality did not recognise property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. Work in progress was released to infrastructure assets prematurely as these assets were not complete at year end and land was not completely recognised. Consequently, property plant and equipment, as disclosed in note 9 to the financial statements, and accumulated surplus are understated by R6,7 million (2018: R7,8 million) and R7,2 million (2018: R5,5 million) respectively; and depreciation, as disclosed in note 30 to the financial statements, is understated by R509 454 (2018: R1,6 million overstatement). Within note 9 to the financial statements, work in progress is understated by R7,7 million with a corresponding overstatement in roads assets.
4. In addition, I was unable to obtain sufficient appropriate audit evidence to address the duplicate assets recorded under property, plant and equipment as disclosed in the statement of financial position and in note 9 to the financial statements. I was unable to obtain the evidence required by alternative means. As a result, I was unable to determine whether any adjustments to property, plant and equipment of R941,7 million (2018: R941,8 million) were required.

Payables from exchange transactions

5. The municipality did not have a system in place to accurately record payables from exchange transactions as disclosed in the statement of financial position and note 15 to the financial statements. Incorrect amounts were recorded as trade payables, retention monies and accrued expenses. Consequently, payables from exchange transactions and general expenses are both overstated by R2,8 million. Furthermore, I was unable to obtain sufficient

appropriate audit evidence for deposits due to the deficient status of accounting records. I was unable to obtain the evidence required by alternative means. As a result, I was unable to determine whether any adjustments to the payables from exchange transaction of R38,5 million disclosed in the statement of financial position and note 15 to the financial statements were required.

Revenue from exchange transactions

6. I was unable to obtain sufficient appropriate evidence that the municipality recognised all revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions*. The municipality did not have adequate internal controls to confirm the indigent status of the customers who were not billed for service charges. I was unable to confirm the revenue from service charges by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the service charges revenue from exchange transactions of R127,1 million and the related receivables from exchange transactions of R9,4 million as disclosed in notes 22 and 5 to the financial statements, respectively.

Irregular expenditure

7. The municipality did not have proper systems in place to identify and record all current year irregular expenditure disclosed in note 44 to the financial statements, as required by section 125(2)(d) of the MFMA. This expenditure resulted from payments made in contravention of the supply chain management (SCM) requirements. I was unable to confirm the amount of current year irregular expenditure incurred by alternative means and it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R563,8 million in the financial statements.

Supply chain management regulations

8. The municipality did not have proper systems in place to identify and disclose all deviations from the Supply Chain Management (SCM) policy in note 45 to the financial statements, as required by section 36(2) of the SCM regulations. I was unable to confirm the amount of deviations by alternative means and it was impracticable to determine the full extent of the understatement of deviations. Consequently, I was unable to determine whether any adjustments were necessary to the deviations disclosed at R64,8 million in the financial statements.

Context for the opinion

9. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
10. I am independent of the municipality in accordance with sections 290 and 291 of the *International Ethics Standards Board for Accountants' Code of ethics for professional accountants* and, parts 1 and 3 of the *International Ethics Standards Board for Accountants' International code of ethics for professional accountants* (including *International Independence Standards*) (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.

11. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

12. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

13. As disclosed in note 41 to the financial statements, the corresponding figures for the 30 June 2018 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2019.

Material losses and impairments

14. As disclosed in note 46 to the financial statements, material water losses of R27,1 million (2018: R23,1 million) were incurred, which represents 53% (2018: 49.9%) of total water purchased. The losses are predominantly due to physical losses from leaks, burst pipes and reservoir overflows. Furthermore, apparent losses are realised due to metering inefficiencies, meter faults, unauthorised and unmetered consumption.
15. As disclosed in note 46 to the financial statements, material electricity losses of R6,3 million (2018: R5,2 million) were incurred, which represents 13,57% (2018: 11,99%) of total electricity purchased. The losses are predominantly due to losses in switchgear, overhead lines, obsolete aluminium lines, underground cables and transformers. Furthermore, losses are attributed to metering, tampering and meter-reading losses.
16. As disclosed in note 32 to the financial statements, material losses of R27,3 million (2018: R28,5 million) were incurred as a result of a movement in the debt impairment provision and a write-off of irrecoverable trade debtors.

Unauthorised expenditure

17. As disclosed in note 42 to the financial statements, unauthorised expenditure to the amount of R58,8 million was incurred due to overspending of cash and non-cash items in various municipal departments.

Fruitless and wasteful expenditure

18. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure to the amount of R11 million was incurred in the current and prior year (restated) due to interest incurred on late payments and interest charged on a court order for the South African Municipal Workers Union (SAMWU) pension fund.

Other matter

19. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of accounting officer for the financial statements

21. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
22. In preparing the financial statements, the accounting officer is responsible for assessing the Ndlambe Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

23. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
24. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

25. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected objective presented in the annual performance report. I was engaged to perform procedures to raise findings but not to gather evidence to express assurance.
26. I was engaged to evaluate the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected objective presented in the annual performance report of the municipality for the year ended 30 June 2019:

Objective	Pages in the annual performance report
Key performance area (KPA) 1 – Basic service delivery	x – x

27. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
28. The material findings in respect of the usefulness and reliability of the selected objective are as follows:

KPA 1 – Basic service delivery

Indicator: Percentage of non-revenue water

29. The target approved in the service delivery and budget implementation plan (SDBIP) was 39%. However, the target reported in the annual performance report was 80%.

Indicator: Compliance to SANS 241

30. The strategic objective approved in the SDBIP was “provide sustainable, efficient, cost effective, adequate and affordable services to all our citizens”. However, the strategic objective reported in the annual performance report was “create a safe and secure living environment”.

Various indicators

31. The targets approved in SDBIP are tabled below. However, the targets reported in the annual performance report (APR) are not consistent with the targets as per the SDBIP, as tabled below.

Indicator	Target as per SDBIP	Actual achievement as per APR
1. Number of households with access to refuse removal and cleansing services as per schedule	20000	Refuse has been collected in 20 000 households 1 x per week, i.e. 4 x per month - skips are being placed for use in informal settlements
3. Percentage compliance with the required attendance time for firefighting incidents (in accordance with SANS 10090)	100%	Ndlambe LM is served by 2 x Fire Stations, i.e. Port Alfred & Bushmans' Rivermouth. This has resulted in a response time of under 30 minutes
5. Percentage implementation of maintenance plan for all Sports fields, parks & cemeteries	100%	A maintenance plan is in place for all sports fields, parks & cemeteries
8. Percentage construction of bulk water infrastructure	100%	No reported achievement in the APR
11. Percentage of non-revenue water	80%	Out of 100 670kl (248 927-148 257) baseline to be reduced in non-revenue water, 80 536kl have been approved
12. Percentage of households with access to electricity	100%	The targeted 20818 H/H has been maintain/serviced to ensure access to electricity

Indicator	Target as per SDBIP	Actual achievement as per APR
13. Percentage households with access to free basic electricity	100%	The targeted 1312 of Ndlambe indigent households have been improved with electricity debt impairment.
14. Compliance to SANS241	100%	Part of compliance with SANS241, all monitoring points are being tested monthly by a registered lab

32. I was unable to obtain sufficient appropriate audit evidence to support the reported achievements of the indicators tabled below. This was due to a lack of technical indicator descriptions and formal standard operating procedures or documented system descriptions that predetermined how the achievement would be measured, monitored and reported. I was unable to confirm the reported achievement of these indicators by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of these indicators as reported in the annual performance report.

Indicator
1. Number of households with access to refuse removal and cleansing services as per schedule
3. Percentage compliance with the required attendance time for firefighting incidents (in accordance with SANS 10090)
4. Number of enforcements patrols carried out on estuaries, coastline and nature reserves
5. Percentage implementation of maintenance plan for all Sports fields, parks & cemeteries
6. Percentage construction of bulk water infrastructure
7. Percentage construction of bulk water infrastructure
8. Percentage construction of bulk water infrastructure
9. Percentage of households with access to basic sanitation
10. Percentage of households with access to water supply
11. Percentage of non-revenue water
12. Percentage of households with access to electricity
13. Percentage households with access to free basic electricity
14. Compliance to SANS241

Indicator: Number of km constructed

33. The achievement for number of kilometres (km) constructed reported in the annual performance report was 7,2km. However, the supporting evidence provided did not agree to the reported achievement and indicated an achievement of 6,5km.

Indicator: Percentage households having access to free basic services

34. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of the percentage households having access to free basic services. This was due to a valid list of indigents not being available for audit purposes. The listing provided included invalid indigent debtors as a result of a system error. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of 99,41% as reported in the annual performance report.

Other matters

35. I draw attention to the matters below.

Achievement of planned targets

36. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 29 to 34 of this report.

Adjustment of material misstatements

37. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of KPA 1 – Basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

38. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
39. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements, annual performance report and annual report

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected or the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Consequence management

41. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) and (b) of the MFMA.

Strategic planning and performance management

42. The SDBIP for the year under review did not include monthly revenue projections by source of collection and the monthly operational and capital expenditure by vote as required by section 1 of the MFMA.
43. The performance management system and related controls were inadequate as it did not describe how the performance measurement, review and reporting processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).

Procurement and contract management

44. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by supply chain management (SCM) regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was also reported in the prior year.
45. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). Similar non-compliance was also reported in the prior year.
46. Awards were made to providers who were in the service of other state institutions in contravention of section 112(j) MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
47. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the Construction Industry Development Board, 2000 (Act. No 38 of 2000) (CIDB Act) and CIDB regulations 17 and 25(7A). Similar non-compliance was also reported in the prior year.
48. Some of the commodities designated for local content and production, were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the supply of fire service uniforms.

49. Awards were made to providers who were in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore, the provider failed to declare that he / she was in the service of the municipality, as required by SCM regulation 13(c).
50. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).

Asset management

51. An effective system of internal control for assets was not in place, as required by section 96(2)(b) of the MFMA.

Liability management

52. An effective system of internal control for liabilities was not in place, as required by section 96(2)(b) of the MFMA.

Expenditure management

53. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
54. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by non-compliances with SCM regulations.
55. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R1,5 million, as disclosed in note 43 to the financial statements, in contravention of section 62(1)(d) of the MFMA. This was due to penalties and interest charged on late payments.
56. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R58,8 million, as disclosed in note 42 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The unauthorised expenditure was incurred due to overspending of the operational and capital budget.

Other information

57. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected objective presented in the annual performance report that have been specifically reported in this auditor's report.
58. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
59. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objective presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

60. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information and, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

61. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
62. Leadership did not adequately discharge its oversight of the implementation and monitoring of internal controls to ensure sound financial and performance management and compliance with legislation. Consequently, the correct tone was not set to ensure that all municipal officials were held accountable for their actions through consequence management. Furthermore, leadership had developed a plan to address external audit findings but significant shortcomings on this plan contributed to the modified financial opinion, the material performance matters and the repeat findings on compliance.
63. The municipality did not have a review process to monitor compliance with all applicable legislation within the municipality. Consequently, non-compliance with applicable legislation was not effectively identified and prevented. In addition, the municipality did not adhere to its SCM policy. There is no plan of action or a formal consequence management strategy to ensure compliance with the SCM policy and these transgressions were not responded to appropriately as no investigations were held in this regard.
64. Management does not have adequate controls over the daily and monthly processing and reconciling of transactions, which resulted in an over-reliance on reconciliations, journals and corrections only after year end. This has contributed to the material misstatements in the annual financial statements and performance information.
65. Record keeping within the municipality remains a challenge. The regular process of collecting and reporting on credible information was not always implemented, most notably relating to the collation, collection and verification, storage and reporting of information to support the actual performance as reported in the annual performance report.
66. The municipality did not have a proper risk management process in place as there were no processes to identify risks and to develop mitigating controls. In addition, the internal audit unit did not review internal controls and compliance with laws and regulations. This was due to a lack of capacity, skills and resources in the internal audit unit and a failure to follow up on issues reported to management. The impaired functioning of the internal audit unit has greatly affected the effectiveness of the audit committee.

Other report

67. I draw attention to the following engagement conducted by a party that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. This report did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
68. One investigation was conducted and finalised in the current year. This related to the fraudulent issuing of driver's licences.

Auditor - General.

East London

30 November 2019



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected objective and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.